United States Court of Appeals for the Second Circuit



INTERVENOR'S REPLY BRIEF

76-5026

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

Docket No. 76-5026

B P/S

In the Matter

of

BANQUE DE FINANCEMENT, S.A., Debtor.

BANQUE DE FINANCEMENT, S.A., Appellant,

FIRST NATIONAL BANK OF BOSTON,

and

CHASE MANHATTAN BANK, N.A., Appellees,



FIRESTONE TIRE & RUBBER COMPANY, Intervenor in support of Appellant.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE

SOUTHERN DISTRICT OF NEW YORK

REPLY BRIEF FOR
THE FIRESTONE TIRE & RUBBER COMPANY,
INTERVENOR IN SUPPORT OF APPELLANT

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TABLE OF CONTENTS

		Page No.
(1)	The Proceeding Filed By Finabank Was Not Impossible Of Being Carried Out By Reason of Swiss Bank Secrecy	2
(2)	The Proceeding Patently Was Not Filed In Bad Faith	3
(3)	The Dismissal Under Rule 119 Was An Abuse Of The Discretion Afforded By That Rule	8
	ANNEX A	Following p. 20

TABLE OF AUTHORITIES

Cases

	Page No.
<u>In Re American Bond & Mort. Co.</u> , 61 F.2d 875 (7th Cir. 1932)	1
In Re Ann Arbor Mach. Corp., 274 Fed. 24 (6th Cir. 1921)	1
Booth v. Clark, 17 How. (58 U.S.) 322 (1854)	23
Butler v. Crumlish, 237 F. Supp. 58 (E.D. Pa. 1964)	3
Chicago Bank of Commerce v. Carter, 61 F.2d 986 (8th Cir. 1932)	1
Clark v. Willard, 294 U.S. 211 (1935)	23
In Re Guanacevi Tunnel Co., 201 Fed. 316 (2d Cir. 1912)	1
<u>Guessefeldt v. McGrath</u> , 342 U.S. 308 (1951)	22
Ilyin v Avon Publications, 144 F. Supp. 368 (S.D.N.Y. 1956)	3
<u>Israel-British Bank (London) Ltd. v. FDIC,</u> <u>536 F.2d 509 (2d Cir. 1976), cert,</u> <u>denied,</u> U.S. (1976)	25
In Re Ives, 113 Fed. 911 (6th Cir. 1902)	1
In Re Neidecker, 82 F 2d 263 (2d Cir. 1936)	20-21

	Page No.
Pepper v. Litton, 308 U.S. 295 (1939)	3
Pritchard & Co. v. Dow Chemical of Canada Ltd., 331 F. Supp. 1215, aff'd 462 F.2d 998 (8th Cir. 1972)	23
Russian Volunteer Fleet v. United States, 282 U.S. 481 (1931)	22
Security Trust Co. v. Dodd, 173 U.S. 624 (1899)	23
Weiner v. Shearson, Hammill & Co., 521 F.2d 817 (9th Cir. 1975)	22-23
STATUTES AND RULES	
Bankruptcy Act	
§ 2(a)(22)	8, 16
§ 376	4, 5, 7, 14, 17, 18
Bankruptcy Rules	
119	1, 8, 14, 15, 16, 17, 21, 22, 25, 26
11-42	4, 5, 7,

OTHER AUTHORITIES

	Page No.
Bankruptcy Act Revision: Hearings on H.R. 31 and H.R. 32 Before the Subcommittee on Civil and Con- stitutional Rights of the Committee on the Judiciary, House of Representa- tives, 94 Cong. 2d Session (Serial No. 27, Part 3)	9, 12, 16, 19
Restatement (Second) Conflict of Laws, § 386, 387, 395	23
Revised Report of the National Bankruptcy Conference Special Committee on Insurance Companies	9, 10, 11-12, 16, 19, 24-25

IN THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Docket No. 76-5026

In the Matter of

BANQUE DE FINANCEMENT, S.A.,

Debtor-Appellant

REPLY BRIEF FOR THE FIRESTONE TIRE & RUBBER COMPANY, INTERVENOR IN SUPPORT OF APPELLANT

The Brief of Appellee, First National Bank of
Boston ("First Boston"), appears to view the dismissal below
as having been based on three grounds: (i) that a Chapter
XI proceeding was impossible because Finabank could not
reveal its creditors; (ii) that the proceeding was filed in
bad faith; and (iii) discretionary dismissal under Bankruptcy
Rule 119.*

^{*} First Boston points out (Brief, p. 2) that its motion to dismiss also claimed procedural insufficiencies in the petition, but admits that the Bankruptcy Court did not base its dismissal on those grounds. Those issues were fully briefed and argued before that court. We note, also, that a creditor actually has no standing to contest a voluntary petition except for lack of subject matter jurisdiction or fraud upon the court. In Re American Bond. & Mort. Co., 61 F.2d 875 (7th Cir. 1932). Chicago Bank of Commerce v. Carter, 61 F.2d 986 (8th Cir. 1932); In Re Ann Arbor Mach. Corp., 274 Fed. 24 (6th Cir. 1921); In Re Ives, 113 Fed. 911 (6th Cir. 1902); see In Re Guanacevi Tunnel Co., 201 Fed. 316, 318-19 (2d Cir. 1912).

Firestone Tire & Rubber Company ("Firestone") in its earlier brief, treated the first of these as one specific instance of the second. This difference, however, is not significant. We will respond on First Boston's basis.

(1) The Proceeding Filed By
Finabank Was Not Impossible
Of Being Carried Out By Reason
Of Swiss Bank Secrecy

At pp. 21-27 of Firestone's earlier brief, we discussed alternative courses open to the court that would have permitted the court to take jurisdiction upon Finabank's petition and (as of its filing date, May 5, 1975) then to have acted in an ancillary capacity assisting in an overall rehabilitation of Finabank. To the extent we have anything to add to that discussion, it appears below in discussing the second and third points. We point out here, however, that First Boston, in its brief (pp. 18, 23, n.) emphasizes that a bankruptcy court is a court of equity. It does not, however, accept the full implications of that fact. Here, dismissal allows First Boston, at the expense of other creditors, to retain a preference obtained after the insolvency proceedings commenced in Switzerland -- a result plainly contrary to the basic intent of the Bankruptcy

Act. Finabank does not itself lose by that result. The losers are its creditors who are in no way responsible for Swiss bank secrecy and who dealt with Finabank on the same voluntary basis as First Boston. Equity acts with utmost flexibility and will not permit a wrong if there is any way to remedy the situation. Butler v. Crumlish, 237 F. Supp. 58, 59 (E.D. Pa. 1964); Ilyin v. Avon Publications, 144 F. Supp. 368, 374 (S.D.N.Y. 1956). Cf. Pepper v. Litton, 308 U. S. 295, 304-5 (1939).

(2) The Proceeding Patently was Not Filed In Bad Faith

In essence, the argument on bad faith appears to be twofold: First, that Finabank knew that there was no prospect of rehabilitation at all, and Second, that Finabank knew it could not comply with Chapter XI because it could not file a full list of creditors by reason of Swiss bank secrecy. (Both assume that "bad faith" is a basis for dismissal at the outset of an original Chapter XI proceeding, notwithstanding the authority to the contrary. See pp. 10-13 of Firestone's original brief.)

We note again what we noted in Firestone's original brief (p. 15), from which, in this respect, First Boston's brief quotes with approval (p. 24, n.): Any

infirmity imposed by Swiss bank secrecy has no peculiar application because this was a Chapter XI petition; it applies equally to a petition under Chapter X or a voluntary petition for straight bankruptcy. It means that foreign banks from countries with bank secrecy laws are denied access to our bankruptcy courts.

In an effort to demonstrate "bad faith," First Boston continues the effort, apparently successful below, to mix two wholly separate concepts and situations. The first is the situation on May 5, 1975 when Finabank's petition was filed, and the second is the situation as affected by subsequent events. Thus, an entire section of First Boston's brief (pp. 7-12) is devoted to Finabank's post-petition admissions of diminishing prospects for rehabilitation and post-petition failures to file schedules. As Firestone pointed out in its original brief (pp. 11-12 and 35-38), these post-petition events are not relevant on First Boston's motion to dismiss, but are relevant only under § 376 of the Bankruptcy Act and Bankruptcy Rule 11-42. As noted at pp. 35-36 of Firestone's original brief, the Bankruptcy Court did not purport to act under § 376 and Rule 11-42, and did not purport to give the notice, hold

the hearing or make the findings ("best interest of the estate" and "interest of the debtor and creditors") absolutely required for a dismissal under that section and Rule.

First Boston's brief nowhere disputes this.

Indeed, its motion to dismiss (A 10) did not seek dismissal under § 376 or Rule 11-42. Nevertheless, it advances statements of the Bankruptcy Judge (for example at the bottom of p. 10 of its brief) clearly referring to his power under § 376 and Rule 11-42. It quotes Judge Babbit as saying, "Does anyone doubt that I could not now adjudicate you a bankrupt because you didn't file a plan or dismiss it on the ground you didn't file a plan?" This is a clear paraphrase of § 376. Shortly after this statement, counsel for Firestone pointed out this distinction to Judge Babbit. (A 189, 192). It also pointed out the same distinction in its brief to the Bankruptcy Court in opposition to the motion to dismiss, stating:

"If, during the course of a [Swiss] moratorium, it becomes evident that the bank is insolvent and will not be able to achieve an out of court reorganization, the commissioner is to be ordered by the court to open bankruptcy proceedings or petition for an arrangement. (Article 35(2)). On June 19, 1975 Finabank's temporary commissioner advised the court that Finabank was insolvent and probably should be liquidated in arrangement proceedings with a

moratorium in the interim.* This, then indicates that, while a Chapter XI petition was appropriate when filed on May 5, 1975, the proceeding perhaps should not continue under Chapter XI. In essence, the debtor appears to be no longer in a position to propose a 'plan' and has so represented to the Swiss court. These events occurring after the filing of the Chapter XI petition here are in no way relevant to the current motion to dismiss the proceedings ab initio. Rather, they indicate that this court should now be prepared to consider proceeding under § 376 and Rule 11-42.

For this purpose, we assume that the debtor has not petitioned under Rule 11-42(a)(2) for an adjudication. If the debtor has not petitioned at all, the 'want of prosecution' provision of Rule 11-42(b)(1) would appear to apply. The debtor has failed to propose -- and practically has abandoned the prospect of proposing -- a plan contemplated by Chapter XI. See Advisory Committee's Note to Rule 11-42.

It patently would not be in the best interests of the 'estate' to dismiss the proceeding. That would merely allow to stand preferential attachments that would consume the estate, leaving nothing for creditors. As indicated at pp. 14-15 above, it is generally agreed that, even under Rule 119, the discretion afforded the court does not contemplate that the court may decline jurisdiction if voidable preferences or attachments exist, at least absent other unusual equities not present here. Section 376 and Rule 11-42 likewise do not contemplate dismissal in such circumstances. See 9 Collier ¶ 10.04[2], pp. 521 et seq. In fact, the same clear purposes that require assumption of jurisdiction here in the first place require that the proceeding not be dismissed now under Rule 11-42." (pp. 40-41)

[&]quot;* Finabank's affidavit indicates some slim hope that a true arrangement might still be worked out, apparently dependent on prevailing in lawsuits. But Finabank's statements to the Swiss court indicate that this is rather a forlorn hope."

First Boston did not thereafter accept the invitation to move under § 376 and Rule 11-42, and it never urged below that the court should -- or even could -- make the required findings. • hearing was ever held on the question of what was in the best interests of the estate, and no finding on that question was made.

The simple uncontroverted fact of record is that, when Finabank filed under Chapter XI on May 5, 1975, there were pending proceedings in Switzerland with a view to rehabilitation. And no one has ever questioned the good faith of those proceedings. The subsequent developments are pertinent only under § 376 and Rule 11-42 and proceedings under that section and Rule were never reached below.

The "bad faith" question inevitably boils down to Swiss bank secrecy and whether Finabank knew on May 5, 1975 that the Bankruptcy Court would refuse to consider the options open to it under the Bankruptcy Act to entertain the American proceeding under Chapter XI as ancillary to the Swiss proceeding. These options are argued fully at pp. 21-25 of Firestone's original brief and we will not repeat them here. If in fact these options were available under the law, i.e., if Firestone is correct that the Bankruptcy Court could have, in the exercise of its discretion, dealt with this case utilizing one or more of these options notwithstanding Swiss bank secrecy, then no

matter what test of appellate review is applied, the petition simply could not, as a matter of law, be said to have been filed in bad faith. If a court has authority to act in the circumstances, seeking exercise of that authority cannot be in bad faith.

(3) The Dismissal Under Rule 119
Was An Abuse Of The Discretion
Afforded By That Rule

At the outset we note that utilization of Rule 119 is inconsistent with the first two points because it assumes that the court's jurisdiction has been validly invoked. Rule affords a discretion not to exercise jurisdiction. In Firestone's original brief, we quoted and discussed extensively the history of Rule 119 and its enabling section, § 2(a)(22), particularly in the light of its genesis in the writings of Dr. Nadelmann. In essence, First Boston, in its brief, simply rejects this history of the purpose and intention of Rule 119, suggesting that Nadelmann's views are perhaps outdated (p. 30), that Rule 119 may not reflect his views in any event (p. 31), and that he has expressed no view respecting what should be done in the event of Swiss bank secrecy (p. 30). We submit that Dr. Nadelmann's views are not outdated and are reflected in Rule 119 and that they supply principles that should be applied in exercising the discretion afforded by Rule 119 and that were wholly ignored below

Indeed, since filing our original brief, we have obtained copies of some new, very recent material that bears out many of the points made in our original brief. The first of these is the Revised Report of the National Bankruptcy Conference Special Committee on Insurance Companies and Foreign Banks, 1976 (hereinafter "NBC Committee Report")* and the second of these is the testimony of Dr. Nadelmann, and papers presented by him, last March in the course of the Congressional hearings on the proposed new bankruptcy acts. See, Bankruptcy Act Revision: Hearings on H. R. 31 and H. R. 32 Before the Subcommittee on Civil and Constitutional Rights of the Committee on the Judiciary, House of Representatives, 94th Cong., 2d Session (Serial No. 27, Part 3), (hereafter "1976 Hearings").

Both the NBC Committee Report and the Nadelmann presentation in the 1976 Hearings make many of the points we made in our original brief.

First, in that earlier brief we repeatedly pointed out that the American Bankruptcy Act in general, and the provisions for taking jurisdiction of local assets of a foreigner in particular, are intended to achieve equality among

^{*} This report has not been published in any publication so far as we know. For the convenience of the Court, we attach it to this brief as Annex A.

all creditors, foreign as well as domestic, and, to that end, a filing of an American proceeding for the very purpose of setting aside local preferential attachments and securing those assets for the estate is entirely proper (notwithstanding some suggestion to the contrary below). (See Firestone's earlier brief at pp. 19-21, 28-29.) The NBC Committee Report states:

"In the case of an unlicensed foreign bank, in order to accomplish the policy of the Bankruptcy Act to secure possession of a bankrupt's assets to effect an equitable distribution among all creditors and to ensure an equitable distribution as between domestic creditors and foreign creditors, there may be situations where the filing of a petition in the United States against the foreign bank may be necessary for the purpose of collecting assets or setting aside preferences or fraudulent transfers." (NBC Committee Report, p. 28).

Second, in Firestone's earlier brief we pointed out that in the circumstances the American proceeding is truly in the nature of an ancillary proceeding and should be viewed as such. (Firestone's earlier brief at p. 26.) The NBC Committee Report comments:

"In the case of a foreign bank which is not engaged in business in the United States, a bankruptcy proceeding would be in the nature of a limited ancillary receivership proceeding to deal with assets which happen to be found in this country - with the likelihood that the interested parties will be relatively large institutions such as banks which have engaged in international transactions with the foreign bank (e.g., foreign exchange contracts in the case of Herstatt). Almost inevitably, by reason of the nature of the entity, the primary proceeding will be conducted at the foreign bank's domicile, at which the special interests of depositors will be a major concern." (NBC Committee Report, p. 22)

Third, we pointed out in Firestone's earlier brief that the exalted status of "local creditor" which First Boston confers upon itself as a basis to beggar all "foreigners", is without substance here. (Firestone's earlier brief, pp. 32-33). The NBC Committee Report expresses this same thought in responding to and rejecting a view expressed in a Comment in the Harvard International Law Journal (cited in the note at p. 38 of Firestone's earlier brief):

"At least in what are called 'reciprocal foreign cases', a primary thrust of the Comment appears directed at protecting the rights of 'United States creditors', despite the fact that the United States Bankruptcy Act is designed to protect the interests of foreign as well as United States creditors and that the 'United States creditors' involved will be persons (most likely financial institutions and other large corporate bodies) which have engaged in transactions overseas with a wholly foreign banking entity rather than engaging in U.S. transactions. By definition, the 'United States creditors' will be such only because of overseas transactions. In any event, the 'United States creditors' of a foreign bank which is not engaging in business in the United States and has no office in the United States are very likely to be in a distinct minority in relation to the 'foreign' creditors of the bank." (NBC Committee Report, pp. 12-13).

Earlier, this NBC Committee Report points out that, in the case of banks in Finabank's situation, the creditors' claims characteristically will not arise out of business transactions in the United States and:

"Rather, the claims will arise out of business transactions entered into with a non-U.S.
office of a non-U.S. bank. It is unlikely that
in the ordinary case the claims would be created
in reliance upon assets located in the United States.
In short, these are not the usual cases of local
claims against local assets." (NBC Committee Report,
p. 5).

Fourth, in Firestone's earlier brief, we made the point that it was not intended that the discretion afforded by Rule 119 was to be used to prefer American creditors over foreign creditors by allowing Americans to retain local preferential attachments. (Firestone's earlier brief, pp. 28-34) Dr. Nadelmann, in his submission to the House Committee, emphasizes the basic intention that equality among all creditors is what the Act is intended to achieve:

"A reciprocity clause would have given the proposal a different color. Reciprocity requirements are used in international dealings. For bankruptcy the device has not been resorted to, however. Aside from the fact that the individual creditor would be punished for no wrong-doing of his, the experience with the clause in the Judgments field has been that local courts tend to find existence of reciprocity not proved. Reciprocity can be understood in many ways. In the bankruptcy field the conflicts rules differ to such an extent that proof of full reciprocity is practically impossible. The requirement would backfire. This way is not commendable either.

Conditions on the international level are most unsatisfactory. The complaints are fully justified.

Exasperation must not lead, however, to false moves. No easy answer exists. Search for remedies has been going on almost everywhere at all times. If a general key existed, it would have been found. The United States could go isolationist, of course, and discriminate against foreign claims but matters would not get better. The United States cannot afford such a policy. Its interest is international protection of creditors rights." (1976 Hearings, p. 1451).

Earlier, he described the situation in capsule form:

"The present Bankruptcy Act has from its original enactment in 1898 dealt with the non-resident debtor who is declared bankrupt abroad and has assets in the United States. A local bankruptcy adjudication is made possible. If assets have been attached, a timely bankruptcy petition can remove preferences. In the bankruptcy proceeding, everybody may prove his claim. In the distributions, marshalling occurs so that those who have received payments abroad must wait until the other creditors have first been paid the same percentage of their claims. The local proceeding may be stayed, temporarily or permanently, if it is advantageous to all concerned, 'the rights and interest of the local creditors duly considered.'

The system has worked well. The local interest is protected and equal treatment is secured to all creditors." (1976 Hearings, p. 1445) (Emphasis added)

In the face of authorities, it is amazing that the argument continues that dismissal is proper on the basis that the interests of "local" American creditors are served because they will thereby receive more than their pro-rata share of the estate.

Finally, in an effort apparently to show that the dismissal is appropriate in order to prevent <u>unfair</u> treatment of American "local" creditors, First Boston says:

"On the other hand, were the funds held at CBI subjected to Swiss jurisdiction, it is clear that at least \$11,000,000 of the \$12,500,000 would be paid over to secret depositor-claimants without any opportunity on the part of the American creditors to challenge their claims effectively or even know who they are. (Exhibit D annexed to Notice of Motion - A.41-2.)" (Brief, p. 32) *

There was no finding below, and no evidence below, that, in the Swiss proceeding, creditors would not be afforded reasonable opportunity to challenge claims of depositors.

Neither of the courts below based its decision on any such ground. But whatever may be the case in that regard, First Boston's argument is another effort to obscure by interweaving two separate considerations.

There are two separate issues here. One is whether at the time Finabank filed its petition (or even now, perhaps), no American Chapter XI proceeding (or, now that rehabilitation is presumably no longer feasible, no straight bankruptcy proceeding pursuant to order under § 376 of the Act and Rule 11-42) was possible. The second issue is whether, assuming that an American proceeding is possible, the court could properly elect under Rule 119 not to entertain such a proceeding. Firestone, in its earlier brief, pointed out

^{*} Finabank, at pp. 29-30 of its original brief to this Court appears to dispute the factual accuracy of the statement.

alternatives that would permit the American court to act notwithstanding Swiss bank secrecy. One permissible alternative, but not the only alternative, would be for the court to take jurisdiction, set aside the preferences, and allow the assets then to be administered as part of the Swiss proceeding. Whether in fact that alternative should be adopted in this case once the court has taken jurisdiction is a question for future consideration of the bankruptcy court under Rule 119. If, at that time, the bankruptcy court decides that the Swiss proceeding is inherently unfair or discriminatory (which it did not decide or even consider in this case), then it may decline to adopt that alternative. If such decision is made, and if there then is no available alternative procedure, dismissal under Rule 119 may then be justified. First Boston's argument assumes that (i) this decision was already made below (which is not the case), and (ii) there is no available alternative procedure. Firestone's earlier brief pointed out that another available alternative is to have a fully American proceeding in which those creditors who disclose their identity and file claims here (and only those) share equally. (As noted in Firestone's original brief (pp. 23-25) this will not result in those creditors receiving more than their pro-rata share.) This latter course is not exactly a new or radical one. It is precisely the very proceeding that the Bankruptcy Act provided for as mandatory

in these circumstances during the 64 years of its life prior to enactment of § 2(a)(22) in 1962. First Boston nowhere addresses itself to why a proceeding of this character is not feasible. It is exactly what would occur if this were an involuntary proceeding and Finabank did not appear, as happened in the Herstatt case. See NBC Committee Report, pp. 5, 22, 1976 Hearings, p. 1508. Section 2(a)(22), and its implementation in Rule 119, were intended to afford the court greater flexibility to adopt alternatives to achieve the purposes of the Act in the most efficient manner where local assets of a foreigner were involved. First Boston would now use Rule 119 as the basis for concluding that dismissal should occur because one new alternative afforded by that Rule is not feasible, notwithstanding that the very proceeding that was mandatory prior to 1962 is both feasible and open to the court.

The point that First Boston now makes, i.e., that, after hearing on notice, the Bankruptcy Court should conclude not to transfer the assets to the Swiss proceeding, is not original with First Boston. Firestone made precisely that point in its brief to the Bankruptcy Court. In fact, First Boston, at pp. 28-29 of its brief to this Court, quotes and adopts a portion of that Firestone brief. But they quote it out of context. In that brief, after discussing alternative approaches, Firestone said:

"All of the foregoing is not to say
that any of the foregoing courses should be
adopted in this particular case or at this
particular time. Rather, the point is that
there was nothing inherent in the original
petition of Finabank that precluded a Chapter XI

§ 2a(22) and Rules 119 and 11-17. When it was filed, this Court had ample flexibility, on the facts then existing, to elect approaches that would obviate any problem arising from the local non-revelation publicly of depositors. This was the very discretion that Rule 119 contemplates. The problem was not one of subject matter jurisdiction and was not one of inherent inability to proceed under Chapter XI. Facts might well develop that, in the particular case, dictate that the particular proceeding should not continue under Chapter XI. But that is a matter for later exercise of discretion and not a basis for an in limine dismissal." (pp. 38-39)

This was immediately followed by the following section heading in Firestone's brief to the Bankruptcy Court:

"The Change of Circumstances In Switzerland Since Filing of The Chapter XI Petition Now Indicates That Adjudication of Bankruptcy May Be Appropriate" (p. 39)

It was in that connection that Firestone said what First Boston now quotes at pp. 28-29 of its brief. Firestone urged then, and urges now, that the Bankruptcy Court, after taking jurisdiction, should act under the criteria of § 376 and Rule 11-42, adjudicating Finabank a bankrupt and converting the proceeding into a straight bankruptcy proceeding, and that, thereafter, it may well develop that an American administration rather than administering the assets in the Swiss proceeding is the best course under Rule 119. Those questions, however, were not reached or dealt with below and the only issue now before this Court is the original motion to dismiss the entire proceeding.

There are two basic grounds of the decisions below: One, that the Chapter XI petition was impossible because, under no circumstances, could there be such a proceeding when Finabank could not reveal its depositors' names to the American court, and Two, that entertaining the American proceeding -- either as a Chapter XI or, upon application of § 376, straight bankruptcy, was, in the court's view not in the best interests of American creditors because no American (or, at least, identified American) would lose by such course and some Americans would be enabled to retain their preferential attachments and thereby collect more than they would if they were required to participate in the estate equally with foreign creditors. The ability of the court to permit administration of the assets in the Swiss proceeding is relevant on the first ground. If, after a hearing where the relevant facts could be brought out, such course proves not to be the fairest one -- and that as a consequence it would be best to administer the assets here -- does not justify the second conclusion.

First Boston's position as to its inability to contest claims in the Swiss proceeding also may be intended to suggest some vague "due process" argument. Additionally, in what appears to be another plea of the same character, First Boston says:

"Thus, but for the Chapter XI Petition, the attached property would go to the attaching creditors. The Court should not assume jurisdiction merely to afford a foreign corporation rights which it would not have under its own law, particularly when the effect would be to severely undercut the rights of local creditors." (p. 34)

This last also appears to suggest some form of negative reciprocity or retaliation. As set forth in quotations earlier in this brief (pp. 10-12) both the NBC Committee Report and Dr. Nadelmann's testimony to Congress consider and categorically reject any such approach. Indeed, the NBC Committee Report displays sharp indignation at such suggestion. The American law grants rights to creditors without discrimination, whether they be American or foreign, and it does not condition those rights on whether the foreigner's country accords similar rights to creditors. Further, even if Firestone were penalized because its European transactions were through a Swiss subsidiary rather than a branch, First Boston does not suggest why this should in any event penalize Finabank's German, Belgium, French and Italian creditors. (A 37).

The "due process" suggestion boils down to a position that, because Swiss law might be unfair to creditors or, at least, less favorable than American law, First Boston should be allowed to retain is preference and collect its full

debt at the expense of others, such as Firestone (and such as banks in Germany, Belgium, France and Italy) who are equally situated and are equally disadvantaged by Swiss law. First Boston's "due process" view would give it far more than it is entitled to -- 100% of its debt -- at the expense of others on the sole basis that it is American and the others are not. In the words of Dr. Nadelmann in the quotation at p. 12 above, by such approach "the individual [foreign] creditor would be punished by no wrong-doing of his. . . ."

This court long ago expressed the view that, when the Bankruptcy Act authorizes a proceeding here involving American situs assets of an alien, the court will not decline jurisdiction on the basis of the lack of due process in the foreign proceeding. In re Neidecker, 82 F.2d 263 (2d Cir. 1936). There, the court pointed out that, while the foreign proceeding under which the bankrupt was adjudicated may well not have met due process requirements, the court need not consider that question since the Bankruptcy Act provided for adjudication here respecting local assets if in fact there had been a foreign adjudication. The court went on to say:

"In short, . . . once distribution has begun elsewhere, we will not allow a scramble of creditors to reach property here. . . "
(82 F.2d at 263)

Given the extensive nature of American due process concepts, it doubtless will be rare to find a foreign bankruptcy proceeding (or any other court proceeding in a non-common law country) that accords with all of our standards of due process. If standards that stringent are applied and deemed a basis for dismissal under Bankruptcy Rule 119, the purpose of that Rule would be perverted into a vehicle to prefer Americans (or attachers) -- a result exactly opposite of what was intended.

As discussed above, there exists another alternative to dismissing the proceeding here and thereby assuring the inequitable distribution of the bankrupt's assets: If the Swiss proceeding be deemed unfair, the American Bankruptcy Court can administer the estate here, and distribute it equally among those filing claims here, rather than sending the assets to Switzerland. To refuse jurisdiction altogether is to deprive Firestone of its right to be treated equally with respect to the American assets. It is not a secret creditor. Its right to an equitable share of the American assets is an American right accorded to all creditors — foreign as well as domestic — by the American

Bankruptcy Act with respect to American situs assets.*

If the appeal be to due process or to fairness of treatment by the Swiss law, it is no answer to allow one to retain a preference out of the American assets at the expense of others equally disadvantaged by Swiss law.

Those who are willing to appear and file claims here should share equally in the American assets as the Act intends.

And lastly, under the heading "Other Relevant Circumstances", First Boston appeals to "Sound policy, in the nature of a doctrine of forum non conveniens" which First Boston says is "implicit in Bankruptcy Rule 119 " (p. 35).

Its position in this regard ignores both the purpose of Rule 119 and the essence of forum non conveniens. The essence of forum non conveniens is that "it presupposes the availability of another, more convenient forum" in which the action may be brought.

Weiner v. Shearson, Hammill & Co., Inc., 521 F.2d 817

^{*} Firestone, even if deemed an alien, also is entitled to due process. Due process protects friendly aliens from the deprivation of their property. Guessefeldt v. McGrath, 342 U.S. 308, 318 (1951); Russian Volunteer Fleet v. United States, 282 U.S. 481 (1931).

820 (9th Cir. 1975). Pritchard & Co. v. Dow Chemical of Canada Ltd., 331 F. Supp. 1215, aff'd 462 F.2d 998 (8th Cir. 1972). The very case cited by First Boston at p. 35 of its brief, states:

"It is well established that where there exists an alternative forum which will take jurisdiction . . . the federal courts possess the inherent power to refuse jurisdiction . . . (331 F. Supp. at 1220) (Emphasis added).

Furthermore, it is universally recognized in American law that the local American courts have primary -- if not exclusive -- jurisdiction over the local assets of an insolvent foreigner. At common law, even as netween states of the United States, the state of the local situs of the assets of an insolvent decides how those assets will be administered (subject to constitutional restrictions against discrimination). See, for example, Restatement (Second) Conflict of Laws, §§ 386, 387, 395 and Reporters Notes to those sections. Clark v. Williard, 294 U.S. 211 (1935), Security Trust Co. v. Dodd, 173 U.S. 624 (1899); Booth v. Clark, 17 How. (58 U.3.) 322 (1854). This is the very rationale for the Bankruptcy Act's conferring jurisdiction over the local assets of a foreigner. An essential element of forum non conveniens is missing. The American court is the only court that may deal with the American assets.

First Boston also argues in this regard that the principal estate is in Switzerland and the principal proceeding there, that the matters involved are predominantly

foreign, etc. (p. 35). That, of course, is practically always true of a bankruptcy proceeding involving local assets of a foreigner. Indeed, in the case of foreign banks, the NBC Committee Report, in the quotations at pp. 10-11 above, recognizes that the American proceeding is in the nature of "a limited ancillary receivership proceeding to deal with the assets which happen to be found in this country." Elsewhere, that Report, again responding to the Comment in the Harvard International Law Journal, and supporting the Committee's view that the Bankruptcy Act should cover foreign banks with local assets, discusses squarely the fact that, in the case of a foreign bank, the principal interests protected are foreign:

"In any event, the 'United States creditors' of a foreign bank which is not engaging in business in the United States and has no office in the United States are very likely to be in a distinct minority in relation to the 'foreign' creditors of the bank." (NBC Committee Report, p. 12-13)

* * *

"Rather than an effort to adjust the Bankruptcy Act to the special problems of a narrow category of foreign banks on the basis of recent experiences in the area of foreign bank insolvency, the Comment seems based upon the theory that the Committee's proposals represent something in the nature of an international giveaway of potential leverage which the United States might exert against foreign countries to obtain better treatment of 'United States creditors' - not only ignoring the fact that in most of the foreign bank cases 'foreign creditors' will be important creditors in the United States proceeding as fully illustrated by the Herstatt and

Finabank cases (mentioned in footnote 29 but subsequently ignored), but also failing to comprehend the fact that the Committee's proposals are intended to deal realistically and fairly with both United States and foreign creditors rather than to preserve some sort of bargaining leverage for the purpose of exacting concessions from foreign countries." (NBC Committee Report, p. 13)

It is also of interest that in the <u>IBBL</u> case, this Court was dealing with local attachments of less than \$3,000,000 (compared to \$12,000,000 here). This Court there described the American proceeding as one "in aid of the order of the High Court that the assets in the United States become available to the creditors on the basis of equality."

<u>Israel-British Bank (London) Ltd. v. FDIC.</u>, 536 F.2d 509,

511, <u>cert. denied</u> , U.S. , 1976.

Interestingly, First Boston employed the

American courts -- in fact the Federal District Court -in order to obtain its preferential attachment. Apparently
it does not question the convenience of an American court
intervening to help it secure a preference. It only questions
the convenience of an American court intervening to
help secure equality for others.

In short, the <u>forum non conveniens</u> considerations advanced by First Boston inhere in any proceeding involving local assets of a non-resident insolvent. Yet such proceedings are an established part of American common law and bankruptcy law.

But First Boston's argument that Rule 119 implicitly incorporates a principle of a similar nature is more to the point than First Boston intended when the full principle is considered. As noted above, forum non conveniens contemplates that there is another forum that may deal with the matter. If no American proceeding is needed to promote equal and fair distribution of the estate, i.e., if the foreign proceeding can deal fully with the American assets in the proper manner, Rule 119 permits the court to dispense with the American proceeding. But where the foreign corrt cannot deal with the American assets -- where those assets have been seized by preferential attachments -- then no foreign court can deal with the matter and the American proceeding is necessary to secure the intended equality and equity. There is American jurisdiction and there is no other forum that has jurisdiction to deal with the matter. In that event forum non conveniens does not authorize dismissal and its implicit incorporation in Rule 119 demonstrates why dismissal under Rule 119 is similarly unauthorized here.

It is respectfully submitted that the Bankruptcy Court erred and that the judgment below should be reversed.

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NATIONAL BANKRUPTCY CONFERENCE REVISED REPORT OF SPECIAL COMMITTEE ON INSURANCE COMPANIES AND FOREIGN BANKS 1976 FOREIGN BANKS This Part of the Report of the Special Committee on Insurance Companies and Foreign Banks deals with the question of the applicability to foreign banks which are not engaged in business in the United States of the proposed Bankruptcy Act of 1975 as set forth in the so-called "Commission's Bill" [H.R. 31, 94th Cong., 1st Sess. (1975)] and the socalled "Bankruptcy Judges' Bill" [H.R. 32, 94th Cong., 1st Sess. (1975)].2 The significance of the question arises from recent bankruptcy proceedings in New York involving insolvent foreign banks which were not engaged in business in the United States but which had assets in the United States - one an involuntary proceeding against a German bank and the others voluntary proceedings brought by an English and a Swiss bank. These cases involve the question of whether the banks, being foreign banks, are "banking corporations" of the type which are exempt from voluntary and involuntary bankruptcy under Section 4 of the Bankruptcy Act. 3 Section 4 of the present Bankruptcy Act provides: §4. Who May Become Bankrupts. a. Any person, except a municipal, railroad, insurance, or banking corporation or a building and loan association, shall be entitled to the benefits of this Act as a voluntary bankrupt. b. Any natural person, except a wage earner or farmer, and any moneyed, business, or commercial corporation, except a building and loan association, a municipal, railroad, insurance, or banking corporation, owing debts to the amount of \$1,000 or over, may be adjudged an involuntary bankrupt upon default or an impartial trial and shall be subject to the provisions and entitled to the benefits of this Act. *** 1. Prepared by the Commission on the Bankruptcy Laws of the United States. 2. Sponsored by the National Conference of Bankruptcy Judges. 3. See, generally, Sovern, Section 4 of the Bankruptcy Act: The Excluded Corporations, 42 Minn. L. Rev. 171 (1957). The Committee gratefully acknowledges the benefit it has received from a critical reading of an earlier version of the Report by Professors Frank R. Kennedy and Kurt H. Nadelmann.

Herstatt: On June 26, 1974, pursuant to the German Banking Law (Gesetz über Kreditwesen), Bankhaus I.D. Herstatt KGaA of Cologne, Germany, a Kommanditgesellschaft auf Aktien, was ordered by the German Bank Supervisory Authority (Bundesaufsichtsamt für das Kreditwesen) to cease business and to liquidate. A Liquidator (Abwickler) was appointed by the court. Represented by the Liquidator, Herstatt filed a petition in the District Court of Cologne (Amtsgericht Köln). The Liquidator filed a petition in the District Court of Cologne under the Arrangements Law of 1935 (Vergleichsordnung) which permits a debtor to avoid bankruptcy proceedings by seeking approval from his creditors of a specific settlement offer in connection with complete disclosure of his financial The court appointed a provisional Administrator (Vergleichsverwalter), the debtor remaining in possession, and reserved decision on admission to the arrangement proceeding. Immediately, various U.S. and foreign creditors of Herstatt attached Herstatt's bank accounts with Chase Manhattan Bank and other banks in New York City amounting to approximately \$165,000,000. With a view toward setting aside the New York attachments, certain other creditors of Herstatt (including one whose attachments in Germany had been set aside) thereupon instituted a bankruptcy proceeding against Herstatt in the United States District Court for the Southern District of New York under the U.S. Bankruptcy Act.

Israel-British Bank: Pursuant to the Companies Act, on August 2, 1974 Israel-British Bank (London) Limited, a banking corporation organized under the laws of the United Kingdom, filed with the High Court, Chancery Division of the United Kingdom, a voluntary petition for the winding up (dissolution) of its affairs. On or about August 6, 1974, a receiving order was made by the High Court appointing a receiver as provisional liquidator of the hank's property. Following attachments of its property in the United States, on September 23, 1974 the bank filed a voluntary straight bankruptcy petition in the United States District Court for the Southern District of New York under the U.S. Bankruptcy Act.

Finabank: On January 7, 1975, the Swiss Federal Banking Commission ordered Banque de Financement S.A. (Finabank), a Swiss bank, to suspend operations and to apply to the Civil Court in Geneva to declare itself insolvent. On January 10, 1975 Finabank filed with the Court of Justice of the Canton of Geneva a petition for a "sursis bancaire" - a moratorium which contemplated the rehabilitation of the debtor if possible and, failing rehabilitation, liquidation. On January 15, 1975 Chase Manhattan Bank caused a levy of attachment to be served out of the United States District Court for the Southern District of New York on Finabank's account with Continental Bank International (CBI). First

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^{1.} Heidenberger, The Bankruptcy Laws of Germany, European Bankruptcy Laws (1974) 122.

National Bank of Boston served an attachment order on January 21, 1975. On January 20, 1975 the Swiss Court appointed a fiduciary company as "Commissaire Provisoire" (Temporary Commissioner) of Finabank. On January 20, 1975, CBI instituted an interpleader action in the United States District Court for the Southern District of New York as a stakeholder naming 18 banks (including one with an attachment) as possible adverse claimants on a large fund held by CBI for Finabank's account. On May 5, 1975 Finabank, acting by the Swiss Temporary Commissioner, filed a petition in the United States District Court for the Southern District of New York under Chapter XI of the Bankruptcy Act on the basis of property located in New York. On June 19, 1975 the Swiss Temporary Commissioner advised the Swiss Court that Finabank was insolvent and probably should be liquidated. On June 26, 1975 First National Bank of Boston filed a motion to dismiss the Chapter XI petition on the ground that the court lacked jurisdiction because banking corporations are barred from relief under the Bankruptcy Act and for certain other reasons, asserting that Finabank's U.S. assets can be dealt with adequately in the CBI interpleader action.

The institution of the bankruptcy proceedings in New York with respect to the defunct foreign banks brought into play the provisions of the U.S. Bankruptcy Act.

The Herstatt case raised the question of the jurisdiction of the Bankruptcy Court to adjudicate a foreign bank a bankrupt in an involuntary case on the basis of assets located in the United States. The Israel-British Bank and Finabank cases raised the question of whether such a foreign bank is entitled to take the benefits of the Bankruptcy Act on a voluntary basis. In other words, does the exclusion of a "banking corporation" from bankruptcy, whether voluntary or involuntary, in Bankruptcy Act §4 apply to a foreign bank not engaged in the business of banking anywhere in the United States?

The <u>Herstatt</u> involuntary case was settled and no decision on the point was rendered by the Bankruptcy Court.

Judge issued an order of adjudication; on October 10, 1975 the decision was reversed by the District Court on the ground that Israel-British Bank falls within the definition of "banking corporation" and is therefore precluded from seeking adjudication as a voluntary bankrupt; but on May 25, 1976 the United States Court of Appeals for the Second Circuit reversed the District Court decision and, "finding no Congressional purpose to command otherwise", held Israel-British Bank not to be a "banking corporation" within the meaning of Section 4a of the Bankruptcy Act.

On January 12, 1976, the Bankruptcy Judge dismissed the

The case also raised the question of whether Herstatt, a German "KGaA" - a type of business organization having some of the attributes of a limited partnership and some of the attributes of a corporation - was a "banking corporation" for the purposes of Bankruptcy Act §4.
 Each bank is clearly a "banking corporation".

Finabank voluntary case, in part on the ground that "a foreign banking corporation may not be a bankrupt, from which it follows that it may not be a debtor seeking relief under Chapter XI of the Act". And, on July 28, 1976, while finding that Finabank is subject to the Bankruptcy Act on the basis of the Second Circuit decision in Israel-British Bank, the District Court affirmed the dismissal on the ground that Bankruptcy Judge nevertheless "acted within his discretion" in dismissing the case - referring to Finabank's "continued failure to file a proposed plan", "concessions" by Finabank's counsel as to "the slim likelihood at present of the successful formulation of a plan", the prohibitions of Swiss law against disclosure of the names of some of Finabank's creditors, and adding:

"Finabank asserts that maintaining the proceedings here, by means of Rule 119 suspension, was necessary to protect the creditors and to insure that the assets located here are equally distributed among all the creditors, and submits that it was inappropriate for the court to abandon the creditors by dismissing the case, an action which permits the attachments to stand. However, as to "the rights of local meditors," there appear to be only four American creditors, Mario Einaudi upon whose claims of direct ownership of interpleaded funds totalling \$160,000 Judge Werker has granted summary judgment in the interpleader action; First National City Bank which claims \$138,803; and Boston Bank and Chase whose claims total approximately \$10,000,000 of the \$12,500,000 standing in Finabank's name in this district. With the possible exception of First National City Bank's relatively minor claim, dismissal has no adverse effect on the American creditors but to the contrary, represents a step toward assuring that they will each recover the sums due them without having to rely on Swiss bankruptcy procedures which are enmeshed with the Swiss bank secrecy laws. Thus, contrary to Finabank's contention, the claims of local creditors appear best protected by dismissal of the case.

"The Bankruptcy Judge also considered the effect of dismissal on foreign creditors and concluded:

....this Court does not shirk from giving the attaching creditors the advantage over foreign creditors which dismissal of this case will insure. See Disconto Gesellschaft v. Unbrecht, [sic] 208 U.S. 570, 582 (1908) where the Supreme Court noted at 582 "... the well recognized rule

^{1.} CCH Bankruptcy Law Rep. ¶65,866.

between states and nations which permits a country to first protect the rights of its citizens in local property before permitting it to be taken out of the jurisdiction for administration in favor of those residing beyond its borders."

"Considering all of the foregoing and upon review of the entire record, the Court finds that the Bankruptcy Judge acted within his discretion in dismissing the case. Accordingly, the granting of the motion to dismiss on the second ground is affirmed and the stay is vacated."

In view of the special treatment recommended for foreign banks of the type discussed in this Report, it is important to emphasize the narrow scope of this Report and what it does not cover. The Report does not deal with the bankruptcy of multi-national foreign banking corporations in general, but, rather, deals only with those foreign banks which meet all of the following conditions:

- 1. The bank must not only be a foreign bank (i.e., organized under the laws of a country other than the United States) but must not be "doing business" in the United States. Excluded from the scope of this Report are foreign banks which have offices (i.e., "branches" and/or "agencies") in the United States and, like multi-national foreign nonbanking corporations having factories, places of business, etc. or otherwise engaging in business in the United States, have creditors with claims arising out of transactions had by them with an office in the United States. In other words, banks covered by this Report will not have creditors with claims based on engaging in business transactions in the United States with a U.S. office of such a bank. Rather, the claims will arise out of business transactions entered into with a non-U.S. office of a non-U.S. bank. It is unlikely that in the ordinary case the claims would be created in reliance upon assets located in the United States. In short, these are not the usual cases of local claims against local assets.
- 2. Notwithstanding the absence of a U.S. place of business, the bank must have assets typically correspondent bank balances or safekeeping deposits of securities which creditors (U.S. and foreign) wish to reach in order to satisfy claims arising out of transactions with a non-U.S. office.

^{1.} As of July 31, 1975, one or more "branch" or "agency" offices were operated in New York City by 66 foreign banks, in California by 36 foreign banks, in Chicago by 15 foreign banks, in Boston by one foreign bank, in Oregon by 2 foreign banks, and in Washington by 4 foreign banks. Compilation of Foreign Bank Activities in United States, American Banker, 7/31/75, p.186. As of June 1975 U.S. agencies of foreign banks had assets of \$26.8 billion and U.S. branches had assets of \$15.7 billion. Washington Financial Reports, 11/10/75, T-7. For reasons discussed on page 27, these banks are not dealt with in this Report.

3. The bank will be in financial difficulty outside the United States.

In short, Herstatt - Finabank and Israel-British Bank-type situations are intended to be covered, where the bank may engage in transactions with U.S. and other persons but not through an office within the jurisdiction of the United States - all in the context of Section 4-103 of the proposed Bankruptcy Act of 1975.

Bankrutpcy Judge Babitt, in dismissing Finabank's Chapter XI petition, stated that "The facts of the matter are that this bank does no business here, its depositors are not here, the bulk of its assets are not here and it is already the subject of comparable proceedings abroad."

Judge Gurfein, in the opinion deciding, in <u>Israel</u>
British Bank (London) Ltd. v. <u>Federal Deposit Insurance</u>
Corporation, 536 F.2d 509 (2d Cir. 1976), that IsraelBritish Bank is <u>not</u> a "banking corporation" within the meaning of Bankreptcy Act §4a, delineated the situation covered by this Report as follows:

"The Israel-British Bank (London) Ltd. ("IBB")
was a British bank engaged in the banking business
in London. It did no banking business in the United
States, nor was it licensed in any state to do such
business. It did borrow Eurodollars and U.S. dollars
from American banks, including appellees, among others.
It also maintained deposits in United States banks.*

"On July 11, 1974, a loan of Eurodollars made to it by the Franklin National Bank ("Franklin"), the principal and interest amounting to approximately \$2,100,000, became due and was not paid. On July 15, 1974, a loan of U.S. Dollars made to it by the Bank of the Commonwealth ("Commonwealth"), a Michigan bank, in the amount of \$500,000 plus interest, became due and was not paid.

"On July 22, 1974, Commonwealth started an action against IBB in the Southern District of New York to recover its loan with interest and obtained an order of attachment in the sum of \$515,385.42 plus probable interest. The order of attachment was served on a number of banks holding deposits of IBB and attachments were made.

^{1.} CCH Bankruptcy Law Rep. ¶65,866.

"On July 26, 1974, Franklin followed suit and obtained an order of attachment which was served on a number of banks in New York. Commonwealth made personal service on IBB in London on August 6, 1974, and obtained a final default judgment for \$519,923.90, which was entered in the Southern District on September 11, 1974. Franklin itself is now being liquidated by appellee Federal Deposit Insurance Corporation.

"In the meantime, while these matters were proceeding in the federal court, IBB, being unable to pay its debts, voluntarily filed a debtor's petition for the winding up of its affairs, pursuant to Section 222 of the English Companies Act, 11 & 12 Geo. 6, c. 38 (1948), with the High Court, Chancery Division, of the United Kingdom. On August 6, 1974, a receiving order was made by that court constituting Arthur Thomas Cheek, Senior Official Receiver, as Receiver and Provisional Liquidator of the property of petitioner.

"On September 23, 1974, before Franklin could obtain a judgment, and before Commonwealth could compel payment of the default judgment it had obtained, IBB filed a voluntary petition in bankruptcy in the Southern District of New York. It was adjudicated a bankrupt on the same day. The appellees promptly filed motions to vacate the adjudication and to dismiss the voluntary petition on the ground that the Bankruptcy Court lacked jurisdiction over the subject matter.

"While the motions were <u>sub judice</u> before Bank-ruptcy Judge Galgay, the High Court in England issued an order dated October 9, 1974 authorizing the appointment of counsel in New York "to take such steps and to institute such proceedings including the filing of a bankruptcy petition against the company as they may advise and as the said Official Receiver may authorize them to take to insure that the assets of the said company situate in the United States of America become available for the benefit of creditors general."

"We take the bankruptcy proceeding here to be in aid of the order of the High Court that the assets in the United States become available to the creditors on the basis of equality. If the assets involved had been situated in the United Kingdom, the High Court could have restrained and set aside the attachment and judgment as having been made within six months of the petition for winding up. See Companies Act, 11 & 12 Geo. 6, c. 38, § 320(1)(1948). But the High Court, of course, has no extraterritorial jurisidiction beyond the United Kingdom.*

"If there is jurisdiction to sustain the American adjudication in bankruptcy of IBB, the American trustee will be in a position to bring a proceeding for avoid-

^{*} Emphasis added.

ance of liens obtained by attachment or judgment within four months of the filing of the petition if the bank-rupt was insolvent at the time. Bankruptcy Act §67a(1), ll U.S.C. §107(a)(1). If there is no jurisdiction to entertain a voluntary bankruptcy petition for IBB, the liens will be good, and appellees will fare better than United States creditors -- among others.

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"IBB, if it is considered simply as a foreign corporation, was entitled to voluntary bankruptcy under Section 2a(1) of the Bankruptcy Act, 11 U.C.C. §11(a) (1), even though it did not have its "principal place of business.. or.. domicile" in the United States, since it had property "within their jurisdiction" (i.e., within the jurisdiction of the Bankruptcy Courts of the United States). As the Bankruptcy Judge found, IBB had property in the Southern District in the form of deposits of money held by five banks in New York City.

"Appellees maintain, however, that IBB is a "banking corporation" and, as such, is not entitled to the benefits of voluntary bankruptcy. Bankruptcy Judge Galgay, in a thorough opinion, held that IBB was not a "banking corporation" within the meaning of the Bankruptcy Act and denied the motions to dismiss the voluntary petition. On appeal, the District Court, Morris E. Lasker, Judge, in an equally scholarly opinion, reversed the decision of the Bankruptcy Court and dismissed the petition in bankruptcy. 401 F.Supp. 1159 (S.D.N.Y. 1975). This appeal followed.

"The case is one of first impression and involves an interesting question of statutory construction. We have concluded that the petition in bankruptcy by IBB should not have been dismissed. We accordingly reverse.

"All parties have briefed the legislative history of Section 4 quite extensively in an attempt to find some elusive clue to its meaning. ***

"If we acknowledge, as did the District Court, that Congress failed to consider foreign banking corporations when creating the exceptions to eligibility for bankruptcy, are we, nevertheless, required to recognize within the exception what was never in its consideration? There is no plain meaning in "banking corporation" to compel such a result. See McBovle v. United States, 283 U.S. 25, 51 S.Ct. 340, 75 I.Ed. 816 (1931), where Justice Holmes found that an airplane was not a "motor vehicle" though it was propelled by a motor.

"Since we cannot find a final answer in the words themselves, we must employ other methods. We may consider the history of the phrase as it finally evolved, with particular reference to the language used in earlier statutes. We may also search for the policy intended to be enacted. *** When the words create a general inclusionary category there is greater reason, perhaps, to accept a literal meaning in the absence of any particular purpose which contradicts it. When the statute is couched in terms of an exception, however, the task is somewhat different, for in the case of an exception we can hardly assume that excluding a particular category from a general class was utterly without purpose. If we find that there was a legislative purpose for the general exception which does not fit the narrower exception at issue, a court may justifiably conclude that the exception at issue is without the statute. Thus, the normal rule of construction is that where words of exception are used, they are to be stictly construed to limit the exception.

"The theme of the Bankruptcy Act is equality of distribution of assets among creditors, ***, and correlatively avoidance of preference to some. *** The road to equity is not a race course for the swiftest.

"We start with the recognition that a foreign corporation which has assets in the United States is generally amenable to bankruptcy here. IBB is such a body under Section 2 of the Act. To find that it is excluded from the general class of entities amenable to bankruptcy one would have to find a reason which illuminates the exception. We can find no convincing reason why a foreign banking corporation, not licensed to do business in the United States, conducting no semblance of a banking business here, and not under the regulatory supervision of any state or federal agency, should not qualify for the benefits of the Act as a voluntary bankrupt.*

"In reading federal statutes, we must also remember that the statutes are written with our federal system in mind. They normally reflect divisions of power between the federal government and the states of the union. Courts over the years have recognized that Section 4 provides for a division of power between the federal government and the states. ***

"So far as Congressional policy can be found for the exclusion of "banking corporations" from the benefit of the Bankruptcy Act, it is this. National banks were always subject to separate federal supervision and regulation, including their liquidation. State banks, chartered by the states, were subject to similar state regulation. [Discussion of legislative history is omitted.]

^{*} Emphasis added.

"This language does not, to be sure, prove that Congress intended to exclude foreign banking corporations from the exception, for they were not the subject of discussion. But the history does tend to explain the exceptions in terms of the considerations of federalism previously mentioned. At this court observed in In re Union Guarantee & Mortgage Co., supra, 75 F.2d at 984:

"The most natural inference is that Congress meant to leave to local winding up statutes the liquidation of such companies; that, since the states commonly kept supervision over them during their lives, it was reasonable that they should take charge on their demise."

"We can find no other compelling reason why Congress chose to exempt banks from the benefits of the Act. Even if no statutory scheme for liquidation existed in a particular state, state courts of equity could fill the statutory gap. The distribution of federal-state power was not between a detailed liquidation statute and no statute at all. It was between control by the state, through its courts, of the liquidation of certain quasi-public corporations, and the liquidation of all other corporations through the federal bankruptcy laws.

"The District Court concluded in a reasoned opinion, nevertheless, that if Congress intended to exclude from bankruptcy adjudication certain companies for which there was already an extensive regulatory scheme for liquidation, then the liquidation laws and banking laws of foreign countries such as the United Kingdom could serve that objective as well as state schemes could. We think this reasoning elides the essential federalism implicit in the Bankruptcy Act.

"It is hardly a cogent argument that a receiver of property may be appointed in a New York State court under \$1202(a)(4) of the New York Business Corporation Law since, if such jurisdiction attached, it would be not because IBB is a "banking corporation", but only because it is a "foreign corporation". And a foreign corporation concededly would be eligible for bank-ruptcy if it has assets here. The availability of an alternative state remedy is not a good argument for appellees.

"This is a case where United States creditors could be harmed if preferential liens were permitted to survive. Despite the speed of communications, the Atlantic Ocean remains as much a barrier to extra-

territorial jurisdiction as ever it did. If IBB had been licensed to conduct a banking business in New York and had taken deposits here, it could be argued with some reason that the State of New York, having assumed supervision, should control the liquidation of its assets in New York rather than the Bankruptcy Court. That is what the New York courts did after the Bolshevik Revolution in the case of Russian insurance companies licensed to do business in New York under the supervision of the Superintendent of Insurance of the State. *** But IBB was never licensed to do business in New York and was never under the supervision of its Banking Department. There is no statute providing for its liquidation under the aegis of the Superintendent of Banks.*

"To find IBB to be a "banking corporation" within the meaning of Section 4 would require a "much clearer manifestation of intention than Congress has furnished." *** Finding no Congressional purpose to command otherwise, we consider IBB not to be a "banking corporation" within the meaning of Section 4a of the Bankruptcy Act. In so doing, we avoid an inequitable result to its creditors, including the other American banks who have lost the race of diligence."

It may be said that the problem which originally prompted this study - the question of the applicability of the "banking corporation" exemption to "foreign banking corporations" - has been rendered moot by the Second Circuit decision in Israel-British Bank, assuming no reversal by the Supreme Court. However, this Report deals with a much broader area than the narrow question decided in Israel-British Bank. Indeed, the decision makes it even more imperative that the procedures of the Bankruptcy Act be adjusted to take into account the special characteristics of "foreign banking corporations" in the context of international bankruptcy, as discussed below.

In addition to the Second Circuit Court of Appeals decision in the <u>Israel-British Bank</u> case, consideration should be given to the recent student Comment by Roger B. Howard, entitled "United States Bankruptcy Jurisdiction over Unregulated Foreign Banks", appearing in the Spring 1976 issue of the Harvard International Law Journal, which is subsumed under the general title of "Developments in the Extraterritorial Reach of United States Law" although limited generally to the applicability of the United States Bankruptcy Act to, and the jurisdiction of U.S. courts over, assets located in the United States.

^{1. 17} Harvard International Law Journal 359 (1976).

The Harvard International Law Journal Comment criticizes some of the proposals contained in this Committee's 1975 Report on Foreign Banks, as well as expressing disagreement with certain fundamental principles embodied in Section 4-103 of the Commission's Bill (Administration of Debtors' Estates Involving More Than One Country) generally along the lines of Professor Nadelmann's constitutional and policy criticisms adverted to at page 16 infra.

while the basis for the tone of urgency in the Comment has been largely undermined by the recent Israel-British Bank decision, the questions raised by the Comment merit consideration. It is not believed, however, that any of the points argued in the Comment is such as to justify changes in the Committee's recommendations.

The criticisms of this Committee's recommendations seem constructed upon a number of incorrect premises:

- 1. Defining the foreign banks of the type dealt with in the legislation as "unregulated foreign banks" seems, on the basis of the arguments developed in the Comment, to carry with it the unarticulated assumption that such banks are in fact "unregulated". The Comment appears to treat the "unregulated foreign banks" as not being subject to any public controls and ignores the official supervision which most countries must exercise over their deposit-taking financial institutions. This misconception leads to such concepts as the hypothesis that a bank may "refuse" to file for bankruptcy in a foreign country (page 394).
- 2. At least in what are called "reciprocal foreign cases", a primary thrust of the Comment appears directed at protecting the rights of "United States creditors", despite the fact that the United States Bankruptcy Act is designed to protect the interests of foreign as well as United States creditors and that the "United States creditors" involved will be persons (most likely financial institutions and other large corporate bodies) which have engaged in transactions overseas with a wholly foreign banking entity rather than engaging in U.S. transactions. By definition, the "United States creditors" will be such only because of overseas transactions. In any event, the "United States creditors" of a foreign bank which

1. Page 400: "*** the problems created by insolvent and unregulated foreign banks should be treated within the context of the federal bankruptcy law. It is imperative that
this is done without delay and by amendment of the current
Bankruptcy Act."

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^{2.} This is not to say that the term "unregulated foreign banks", as defined by the author in footnote 4, does not accurately describe the type of banking institution covered by this Report, but, rather, that the author fails to take into account the fact that "unregulated foreign banks" are as a rule in fact regulated by public authorities in the country of its domicile. Use of the term "unregulated" carries an unwarranted pejorative connotation.

is not engaging in business in the United States and has no office in the United States are very likely to be in a distinct minority in relation to the "foreign" creditors of the bank.

3. The Comment appears to take the position that the

- rights proposed to be given by the United States "unilaterally" (page 396) to the foreign representative (characterized at page 387 as "endowing" the foreign representative "with a wealth of legal strategies") is an act of "generosity" motivated by the "naive" hope that a foreign court will "appreciate" the United States action (pages 395-396) - granting "new rights to the representatives of foreign courts without adequate regard for possible discrimination by these courts against United States Interests" (page 386) and with only "a slight chance that foreign courts which do not discriminate against United States creditors will react favorably to their new rights and grant similar rights to United States courts" (page 395). Rather than an effort to adjust the Bankruptcy Act to the special problems of a narrow category of foreign banks on the basis of recent experiences in the area of foreign bank insolvency, the Comment seems based upon the theory that the Committee's proposals represent something in the nature of an international giveaway of potential leverage which the United States might exert against foreign countries to obtain better treatment of "United States creditors" - not only ignoring the fact that in most of the foreign bank cases "foreign creditors" will be important creditors in the United States proceeding as fully illustrated by the Herstatt and Finabank cases (mentioned in footnote 29 but subsequently ignored), but also failing to comprehend the fact that the Committee's proposals are intended to deal realistically and fairly with both United States and foreign creditors rather than to preserve some sort of bargaining leverage for the purpose of exacting concessions from foreign countries.
- 4. The Comment puts emphasis upon the fact that in various countries domestic reditors are treated more favorably than foreign creditors and criticizes the recommendations of the Committee for conferring rights upon foreign creditors without receiving something in return and speculates that the recommendations "will reduce pressure on the foreign government to adjust its discriminatory laws" (page 395). Apart from the philosophical and policy difficulties with this position, it seems clear that, in exercising its discretion under Section 4-103(c) [Power and Discretion of the Court], the Bankruptcy Court will have the power to examine into the fairness to creditors (United States or otherwise) of any foreign proceeding and to take into account the concerns expressed in the Comment for situations "where foreign law discriminates against foreign claims", or the foreign bank "refuses to file for bankruptcy in a foreign country", or the "foreign regulatory officials inform their domestic creditors in advance of a bank insolvency" (page 304) or other supposed official and unofficial abuses which may be visited upor "United States creditors"

foreign representative (page 395) - is designed, on the basis of practical experience in the Herstatt case, to facilitate the U.S. proceeding rather than to give any extraordinary rights to the foreign representative and is, in any event, conditioned upon compliance by the foreign representative with the orders of the U.S. Bankruptcy Court. 5. The Comment takes the unrealistic position that the Committee's recommendations fail "to protect the stability of the banking system" by creating an impediment to the institution of an involuntary bankruptcy proceeding in the United States against a bank - suggesting in effect that this would cause a creditor to "file in a state court as quickly as possible if he has reason to believe that an unregulated foreign bank is insolvent" (pages 395-396) - all of which appears to be unwarranted and incorrect speculation. Again, the Comment in effect equates banks with non-financial organizations and fails to appreciate the special legal, business and social characteristics of banking institutions as discussed infra. While much is made of the rights of "creditors", particularly "United States creditors", the Comment fails to take into account the fact that generally the principal "creditors" of a bank are its depositors, which in large measure accounts for the heavy governmental regulation of banking institutions and for the basic reason for special treatment - most of whom, at least in numbers, will not be "United States creditors" in the case of an "unregulated foreign bank". A. Present Law. The following is a summary of the provisions of the present Bankruptcy Act dealing with the administration of bankrupts' estates which involve more than one country. 1. Presence of Foreign-Owned Property in United States. Under Section 2a(1) of the Bankruptcy Act, the U.S. Bankruptcy Courts have the power to adjudge persons bankrupt "who do not have their principal place of business, reside, or have their domicile within the United States, but have property within their jurisdiction". Bankruptcy Rule 116(a) (2) (B). 1. Riesenfeld, The Status of Foreign Administrators of Insolvent Estates: A Comparative Survey, 24 Am. J. Comp. L. 288, 296 (1976): "Relief under Section 4-103(b), however, is totally discretionary and may not be granted if it would result in unequal treatment or inconvenience to local creditors or otherwise be inconsistent with the policies of the U.S. bankruptcy law or the standards of fairness and justice governing domestic proceedings."

in foreign countries. 1 Further, the proposal to permit a

foreign representative to appear specially in a U.S. Bankruptcy Court - which the Comment appears to regard as a favor to the

14

15 2. Exercise of Jurisdiction by Bankruptcy Court in Cases of Concurrent Administrations: Power to Decline Jurisdiction either Temporarily or Permanently where there is a Foreign Adjudication. A bankruptcy adjudication outside the United States does not prevent a U.S. Bankruptcy Court from assuming jurisdiction over a non-resident bankrupt having property in the United States. Even in cases where it would be advantageous to decline the second bankruptcy, until 1962 it was doubtful that a U.S. Bankruptcy Court had the power to refuse the second bankruptcy. 1 However, in 1962 in order to make it clear that jurisdiction over a foreign bankrupt is not obligatory, Section 2a of the Bankruptcy Act was amended to give the Bankruptcy Court express power, even though the bankruptcy petition satisfied the U.S. jurisdictional requirements, to: (22) Exercise, withhold, or suspend the exercise of jurisdiction, having regard to the rights or convenience of local creditors and to all other relevant circumstances, where a bankrupt has been adjudged bankrupt by a court of competent jurisdiction without the United States. Bankruptcy Rule 119 (Bankrupt Involved in Foreign Proceeding) provides that where a proceeding has been instituted by or against a bankrupt for "liquidation or rehabilitation" of his estate in a foreign court2, the Bankruptcy Court may dismiss or suspend the U.S. proceedings "under such terms as may be appropriate". It has been suggested that, while an adjudication may be indicated to protect creditors where preferences have been obtained, a separate U.S. adjudication and admin-istration may serve no useful purpose in a particular case. 3. U.S. Trustee in Bankruptcy is Empowered by the Bankruptcy Act to Claim Estate Assets Located Outside the United States. Under Section 70a of the Bankruptcy Act, the trustee in bankruptcy is vested by operation of law, without the necessity of any court order or instrument of conveyance, with the title of the bankrupt to all of the specified kinds of nonexempt property "wherever located" including "(5) property including rights of action, which prior to the filing of the petition he could by any means have transferred . . . ". 1. Nadelmann, The National Bankruptcy Act and the Conflict of Laws, 59 Harv. L. Rev. 1025, 1041(1946). 2. The phrase "adjudged bankrupt by a court" in §2a(22) is expanded in Rule 119 to "a proceeding for the purpose of the liquidation or rehabilitation of his estate". Cf. Bankruptcy Act §65d discussed under paragraph 4 below. 3. Nadelmann, The American Bankruptcy Act and Conflicting Administrations, 12 Int'l. & Comp. L.Q. 684, 685 (1963).

16 There was at one time a difference of opinion as to whether Section 70a which vests the trustee with title to the property of the bankrupt, applies to property located abroad as well as at home. However, in 1952 Section 70a was amended to make it clear that title to such property vests in the U.S. trustee, whether or not such title will be recognized outside the United States. Section 7(a)(5) provides that it is the duty of the bankrupt to "execute and deliver to his trustee transfers of all his property in foreign countries". 4. Marshalling of Assets - Equalization - In Case of Foreign and Domestic Bankruptcy Adjudications. In the event the foreign assets of a bankrupt cannot be included in the bankruptcy declared in the United States because of the existence of another adjudication abroad and in case individual creditors obtain payments out of the foreign assets, such foreign payments must be taken into account in the U.S. distribution. Section 65d of the Bankruptcy Act provides: d. Whenever a person shall have been adjudged a bankrupt by a court without the United States and also by a [United States] court of bankruptcy, all creditors with claims allowed by the [United States] court of bankrupty who have not had a dividend paid or declared in their favor by the court without the United States. shall first be paid a dividend equal to that paid or declared in such foreign court in favor of other creditors of the same class under this Act, before creditors who have had a dividend paid or declared in their favor by such foreign court shall be paid in any amount in the [United States] court of bankruptcy. A non-U.S. creditor may file a claim in a U.S. bankruptcy proceeding. However, Section 65d in effect subordinates creditors (whether U.S. or foreign) who have filed claims and obtained a payment in a foreign bankruptcy proceeding until such time as creditors who have filed claims in the U.S. bankruptcy proceeding receive a payment equal to that paid in the foreign proceeding. After effecting this equalization, the balance of the estate will be distributed ratably to all creditors filing claims in the U.S. proceeding. QUAERE: It would appear that confining the operation of Section 65d to cases where there has been a foreign adjudication is unduly narrow. Payments may be made abroad in a non-bankruptcy proceeding. For example, Herstatt was never "adjudged a bankrupt". 1. Cf. Nadelmann, The National Bankruptcy Act and the Conflict of Laws, 59 Harv. L. Rev. 1025, 1029 (1946) with 4 Remington Bankruptcy \$1378 (1943).

B. Proposed Law.

Section 4-1031 of the proposed Bankruptcy Act of 1975 deals with the "Administration of Debtors' Estates Involving More than One Country". Subdivision (b) would give a foreign trustee in bankruptcy or other representative of a foreign bankrupt's estate certain options which are not presently provided for by the existing Bankruptcy Act - (a) to file a bankruptcy petition against the bankrupt in the United States, or (b) to petition the Bankruptcy Court to dismiss or suspend bankruptcy proceedings pending in the United States, or (c) to seek to stay the commencement or continuation of law suits against the bankrupt or the enforcement of judgments against him or liens against his property, or (d) to seek delivery to him of the bankrupt's property in the United States.

In a Memorandum dated May 3, 1975 entitled "The Bankruptcy Bills' Conflicts Provision: A Threat to the National Interest", Professor Kurt H. Nadelmann has severely criticized Section 4-103 on both constitutional and policy ground. He states that enactment of the section would produce "a fundamental change in the American conflicts system", that the new rights to be given the foreign trustee are undesirable and that the overall proposal is ill-considered. Professor Nadelmann is concerned about the lack of reciprocity in foreign countries. He recommends the use of bilateral bankruptcy treaties.

^{1.} Section 4-102 of the Bankruptcy Judges' Bill.

^{2.} But see: Riesenfeld, The Status of Foreign Administrators of Insolvent Estates: A Comparative Survey, 24 Am. J. Comp. L. 288 (1976).

^{3.} See also Nadelmann, Codification of Conflicts Rules for Bankruptcy, 30 Schweizerisches Jahrbuch für Internationales Recht 57, 97 (1974) ("Problems in international bankruptcy law should be included in the UNCITRAL [United Nations Commission on International Trade Law] program with priority status"); Hunter, The Draft Bankruptcy Convention of the European Economic Communities, 21 Int'l & Comp. L.Q. 682 (1972).

COMMITTEE NOTE

- 1. This subdivision appears to resolve the question under present law of the standing of creditors to have a petition dismissed.
- 2. This subdivision does not deal with a case where, say, a bank is being liquidated or rehabilitated pursuant to administrative rather than judicial procedures, such as by a banking authority. Consideration should be given to covering all forms of insolvent administration.
- 3. Given the special procedures which are often applied to banks encountering financial difficulties (sometimes referred to as a "problem bank"), the precise meaning of "rehabilitation" proceedings should be defined. Administrative efforts far short of anything comparable to, say, a Chapter X reorganization or a Chapter X arrangement, but which may be said to be designed for "rehabilitation", may well be applied to a bank. Thus the Federal Reserve Bank of New York, in its discussion of "Resolving the Problem of Franklin National Bank", prefaced its remarks:

"For a period of five months beginning in early May [1974], the problems of the Franklin National Bank occupied much of the attention of the senior officers and a number of the operating functions of this Bank. Under a program of credit assistance adopted early in May and continued through the ensuing months, the amounts of this Bank's advances to Franklin National rose from \$125 million on May 9 to \$1,723 million on October 8, the day that Franklin National was declared insolvent by the Comptroller of the Currency and this Bank's advance to Franklin was assumed by the Federal Deposit Insurance Corporation (FDIC)."

- \$4-103 (b) Petition or Complaint by a Foreign
 Trustee or Administrator. A trustee, administrator,
 or other representative of a debtor's estate appointed
 in a proceeding in a court of competent jurisdiction
 in another country for the purpose of its liquidation
 or rehabilitation may file any of the following pleadings in the bankruptcy court:
- (1) a petition as a creditor pursuant to section 4-205 of this Act [creditor's petition for relie] under the Act] if the debtor is subject to involuntary relief as provided in section 4-204 [Debtors Subject to Involuntary Relief];
- (2) a complaint seeking dismissal or suspension of a case commenced under this Act by or against the debtor;

^{1.} Federal Reserve Bank of New York, Sixtieth Annual Report (For the Year Ended December 31, 1974) 22.

(3) a complaint seeking an injunction stay the commencement or continuation of an action against the debtor, or the enforcement of any judgment against him, or of any act of the commencement or continuation of any court proceeding to create or enforce any lien against his property; or*

(4) a complaint seeking delivery of the property of the debtor's estate or its proceeds.*

OFFICIAL NOTE

3. Subdivision (b) gives the foreign trustee or other representative of an estate undergoing administration abroad an option to commence a case under the Act or to obtain relief from the bankruptcy court ancillary to the foreign administration. A case commenced by the foreign trustee's petition would proceed in the same way as a case commenced by an eligible creditor against the debtor under §4-205 of the Act [creditor's petition for relief under the Act]. This section is not a limitation, however, on the availability of relief under the other chapters of the Act to any eligible petitioner, except as the court may, in the exercise of its discretion pursuant to subdivision (c) dismiss, suspend, or condition the continuation of a case. The section does not override the general American rule of conflict of laws that foreign trustees may not defeat rights acquired by local creditors through levy on local assets, but the provisions of the section authorizing injunctions staying actions against the debtor and his property will enable the foreign trustee to protect the estate against dismemberment by local actions in this country without the necessity of commencing a bankruptcy or rehabilitation case under this Act. Nothing in the Act precludes a state or federal nonbankruptcy court from recognizing as a matter of comity at the behest of a foreign trustee a stay or injunction emanating from a foreign court having jurisdiction of the administration of a debtor's estate. If it is necessary, however, to avoid a transfer that occurred before relief is sought pursuant to this section, the foreign trustee or an eligible creditor will ordinarily be well advised to file a petition pursuant to §4-205. Cf. Restatement (Second) of Conflict of Laws \$387, comment h

^{*}Under Section 2-201(b)(1) the jurisdiction of the Bankruptcy Court will extend to the issues presented by a complaint filed by a foreign trustee, administrator or representative under this clause.

41 (1971); Nadelmann, Revision of Conflicts Provisions in the Bankruptcy Act, 1 Int. & Comp. L.Q. (4th Ser.) 484 (1952), 27 Ref. J. 53, 55 (1953). COMMITTEE NOTE 1. This subdivision deals with the "adjudication" problem under Bankruptcy Act §§2a(22) and 65d, but it does not deal with a foreign liquidation or rehabilitation pursuant to administrative procedures. 2. The Committee believes that the term "representative", as used in this subdivision, indicates any person who is entitled to bind the debtor's estate, irrespective of title and manner of appointment or authorization. In addition to the terms "trustee" and "administrator", it is suggested that the word "liquidator" be included in view of the fact that such term is used in the Bankruptcy Convention of the European Economic Community. CCH Common Market Reports ¶6112 et seq. 3. As a practical matter, particularly in the case of a foreign bank, the foreign representative is not likely to be willing to utilize this subdivision because of apprehension that, as a consequence, he will subject himself to U.S. jurisdiction for suit. 1 To make this subdivision fully effective, the foreign representative should be entitled to exercise the rights provided therein without submitting himself to U.S. jurisdiction for other purposes. Cf.: Bankruptcy Act §17c(3) ("A creditor who files such application does not submit himself to the jurisdiction of the court for any purposes other than those specified in this subdivision c.") If, however, it is decided not to change the subdivision in this regard as a general matter, it is nevertheless recommended that at least the limited change discussed below be made for foreign bank representatives. If only for the information that such a representative would be able to provide regarding the nature and status of the foreign proceeding, the presence of such a representative should be of considerable importance to the U.S. Bankruptcy Court in arriving at a decision as to how to proceed with the matter. 2 At least in the case of a bank, the foreign representative should be permitted to appear for the purposes of requesting the U.S. Bankruptcy Court to transfer jurisdiction of the matter to the foreign proceeding without concern for subjecting himself to the jurisdiction of the U.S. courts for all purposes - much in the same manner as a foreign defendant may under the Federal Rules appear and contest jurisdiction without thereby subjecting himself to jurisdiction. In the event that the U.S. Bankruptcy Court decides to take jurisdiction, such a foreign representative might then still 1. Cf. Katchen v. Landy, 382 U.S. 323 (1966), holding bankruptcy court had jurisdiction to allow a counter-claim against creditor who had filed a proof of claim. 2. Cf. Bankruptcy Act §§177, 178 (participation by appropriate regulatory commission in reorganization plan for intrastate public utility).

have the option of appearing or not appearing, and such option would not have been foreclosed by his position and activities on the guestion of jurisdiction.

It may be said that a foreign representative could appear in the U.S. bankruptcy proceeding in such manner under present law that he will not become subject to a judgment in personam and that, even if the U.S. Court rendered such a judgment, the courts of his country would not recognize the judgment. Nevertheless, in view of the desirability of having the foreign representative physically present in the U.S., any doubt in this regard should be explicitly dispelled in the statute. The presence of the foreign liquidator is particularly important where negotiation of a compromise (as in a Chapter XI-type proceeding) - which can be lengthy and complex, as in the case of the Herstatt settlement - would be in the best interests of the creditors. Awkward situations e.g., the necessity for holding negotiating sessions outside the United States - can develop when the foreign liquidator who is a central figure in the negotiations is hesitant to enter the jurisdiction of a U.S. Court.

In the case of a foreign bank which is not engaged in business in the United States, a bankruptcy proceeding would be in the nature of a limited ancillary receivership proceeding to deal with assets which happen to be found in this country - with the likelihood that the interested parties will be relatively large institutions such as banks which have engaged in international transactions with the foreign bank (e.g., foreign exchange contracts in the case of Herstatt). Almost inevitably, by reason of the nature of the entity, the primary proceeding will be conducted at the foreign bank's domicile, at which the special interests of depositors will be a major concern. Special rules are needed to deal with the negotiations in the United States which may well attend this special insolvency situation.

3. As to the time at which a complaint is to be filed under clause (4) of this subdivision, it is understood that it is not necessary for the foreign representative to proceed under clause (1) before proceeding under clause (4).

§4-103 (c) Power and Discretion of the Court. After a hearing on notice issued pursuant to the filing of a complaint under subdivision (a) or clause (1) or (2) of subdivision (b), the bank-ruptcy court may dismiss, suspend, or continue the case commenced under this Act, on such terms as may be appropriate. In addition, the court

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may issue injunctions, turnover orders, and other appropriate relief in a proceeding under this section, whether or not a petition has been filed by or against the debtor under this Act. In exercising its discretion under this section, the court shall be guided by a consideration of what will best assure an economical and expeditious administration of the debtor's estate consistent with the objectives of fair and equitable treatment for all creditors, the protection of local creditors against prejudice and inconvenience in the processing of their claims, the avoidance of preferential and fraudulent dispositions of the debtor's property, the distribution of proceeds substantially in accord with the order prescribed by this Act, and, where appropriate, the provision of an opportunity for a fresh start for the debtor.

OFFICIAL NOTE

2. Subdivisions (b) & (c). Except for the authorization of the court in subdivision (c) to dismiss, suspend, or continue a case commenced under the Act. subdivisions (b) and (c) are new. The authorization for a turnover order at the behest of a foreign trustee or other representative extends a rule developed in this country in cases involving the administration of decedents' estates and receiverships. Matter of People of New York, 242 N.Y. 148, 168, 151 N.E. 159, 166 (1926) (funds in hands of New York Superintendent of Insurance ordered transmitted to Norwegian. trustee in bankruptcy); Restatement (Second) of Conflict of Laws §§331, 386 (1971). Recognition accorded a foreign trustee or representative pursuant to subdivisions (b) and (c) should enhance the likelihood that a trustee of an estate appointed or elected in this country will be accorded respect when he sues to recover property located abroad. Cf. Nadelmann, The National Bankruptcy Act and the Conflict of Laws, 59 Har. L. Rev. 1025, 1043-44 (1946).

COMMITTEE NOTE

The Committee believes that, in exercising its discretion under this section, the Bankruptcy Court should have the power to examine into the fairness to creditors of pending foreign proceedings. It would appear that such flexibility is implicit in the section.

The effect of a pay at to a creditor pursuant to a distribution in a bankruptcy or reorganization proceeding abroad on the right of the creditor to a distribution in a concurrently pending case under the proposed Act is dealt with in §4-405(e):

§4-405 (e) Effect of Payment or Transfer Received in Another Country. In ordering or approving any dividend or distribution in a case under this Act, the administrator* shall take into account any dividend or distribution in a liquidation or rehabilitation proceeding, and any other payment or transfer of property to a creditor, when made in another country after the date of the petition under this Act. Although the claim of such a creditor may be allowed in the case under this Act, he shall not be paid any dividend or receive any distribution in the case until each of the other creditors of the same class whose claims are allowed has received a dividend or distribution equal in value to the consideration received after the date of the petition by such creditor in the other country.

OFFICIAL NOTE

13. Subdivision (e) is an adaptation of \$65d of the Act. The hotchpot rule it codifies is extended to cover situations in which rehabilitation or bankruptcy was the objective in the case instituted in this country and where either was the objective in a proceeding in the other country that resulted in a distribution. Subdivision (e) also deals with the case where a creditor receives a payment from the debtor's estate outside the United States after the commencement of the case under this Act. A payment outside this country prior to the date of the petition under this Act would of course reduce the creditor's claim pro tanto and, if the payment was a voidable preference, would be a bar to the allowance of any claim to the creditor under §4-403 (b) (2) notwithstanding the place of the payment. See In re Pacat Finance Corp., 295 Fed. 394, 401-02 (S.D.N.Y. 1923); In re Pollman, 156 Fed. 221 (S.D.N.Y. 1907). The subdivision preserves the effect of the amendment of §65d in 1952 to eliminate the distinction between resident and nonresident creditors. See Nadelmann, Revision of Conflicts Provisions in the Bankruptcy Act, 1 Int. & Comp. L.Q. 484 (4th Ser. 1952), 27 Ref. J. 53 (1953).

COMMITTEE NOTE

1. The phrase "any other payment or transfer of property to a creditor" covers an involuntary payment such as pursuant to a judgment [§1-102(46) definition of "transfer"]; and it should not be read literally to cover payments

^{*} The "court" in the Bankruptcy Judges' Bill.

25 or transfers (such as payments and transfers for new value) which do not have the effect of reducing an existing obligation to the creditor. Perhaps consideration should be given to clarifying the phrase "any other payment or transfer of property to a creditor" by the words "which has the effect of reducing his claim". 2. It is believed that the term "debtor's estate outside the United States" means in the case of a multicountry bankruptcy simply "funds or property located outside the United States". The following bankruptcy principles are relevant to the question of the applicability of the Bankruptcy Act to foreign banks: 1. The filing of a petition in bankruptcy results in placing the bankrupt's property in his possession under the control of the Bankruptcy Court. 2. When a trustee in bankruptcy is appointed, the trustee not only automatically takes title to the bankrupt's property as of the date of the filing of the bankruptcy petition, "wherever located" and whether or not in his possession, but the trustee has broad power to invalidate for the benefit of all creditors pre-bankruptcy transactions involving preferential and fraudulent liens, transfers, and payments made within limited periods of time prior to filing. 3. As representative of the creditors with the status of any actual creditor of the bankrupt with a provable claim, the trustee has the power under Section 70e of the Bankruptcy Act to set aside any transfer or obligation which by nonbankruptcy law, State or Federal, is voidable by any actual creditor having a provable claim in bankruptcy. In addition, the trustee's status under Section 70c (the so-called "strongarm clause") is a hypothetical creditor with a lien by judicial proceedings as of the date of bankruptcy enables him to invoke any nonbankruptcy avoiding law which a creditor (whether or not such a creditor exists) could have invoked at that time. 4. Further, the trustee may set aside "fraudulent conveyances" effected by the bankrupt within one year prior to the date of bankruptcy under Section 67d, supersede assignments for the benefit of creditors under Section

2a(21), avoid "preferential" transfers effected by the bankrupt within four months prior to the date of the petition under Section 60, avoid judicial lines such as attachments under 67a and subordinate or avoid statutory liens on personal property under Section 67c.

In commenting upon the 1962 amendment to Section 2a to give the Bankruptcy Court discretionary power to:

(22) Exercise, withhold, or suspend the exercise of jurisdiction, having regard to the rights or convenience of local creditors and to all other relevant circumstances, where a bankrupt has been adjudged bankrupt by a court of competent jurisdiction without the United States;

Professor Kurt H. Nadelmann stated in <u>The American Bankruptcy</u> <u>Act and Conflicting Administrations</u>. 12 Int'1 & Comp. L.Q. 684, 685 (1963):

Under the bankruptcy law of the United States jurisdiction in bankruptcy may be assumed against non-resident debtors who have assets within the United States. An adjudication abroad is no obstacle to assumption of jurisdiction. Concurrent administrations thus are a possibility. The availability of power not to exercise jurisdiction, or to suspend the exercise, therefore is of practical interest. An adjudication in the United States may be indicated to protect the interests of the creditors. If preferences were obtained, by attachment or otherwise, it may be the only means to secure the equal distribution of the local assets among all creditors. On the other hand, a local adjudication and administration may serve no useful purpose in the individual case. (Emphasis added)

The special characteristics of a bank, coupled with the pervasive supervision and regulation of the banking industry by Federal and State bank supervisory authorities which include special schemes for liquidation of insolvent institutions, amply justify the exemption of domestic banks from amenability to the jurisdiction of a bankruptcy court, as provided in present Bankruptcy Act §4 and as proposed in Bankruptcy Act of 1975, §§4-201 and 4-204. The same considerations also apply to foreign banks which are licensed by State banking authorities to engage in business in the United States and are subject to liquidation by a U.S. bank super-

visory authority. 1 Branches and/or agencies of foreign banks in the United States are permitted only by the laws of ten States - namely, Alaska, California, Georgia, Hawaii, Illinois, New York, Massachusetts, Missouri, Oregon and Washington where they are subject to supervision by State banking authorities as in the case of domestic banks. If there are deficiencies in the State liquidation procedures relating to foreign banks operating in a particular State, such deficiencies should be corrected by State legislation, as in the case of domestic banks operating in such State. In any event, questions involving the basic structure of the foreign banking industry in the United States are presently under intensive, and in many respects controversial, consideration by the Federal Reserve Board as well as by Congress, 3 and it would be premature for this Committee to make recommendations until the outcome is settled. However, such considerations do not apply to a foreign bank which is not licensed in the United States there is no Federal or State banking regulatory scheme dealing with such a bank or its assets.

^{1.} For a discussion of foreign banks doing business in the United States, see, generally, Lichtenstein, Foreign Bank Participation in United States Banking: Regulatory Myths and Realities, 15 B.C. Ind. & Comm. L. Rev. 879 (1974); Halperin, The Regulation of Foreign Banks in the United States, 9 Int'l Lawyer 661 (1975).

^{2.} For example, see: New York Banking Law §606(4)(a)(Superintendent of Banks liquidates foreign banks as provided, with certain exceptions, for New York-chartered banks); SEC noaction letter in The Taiyo Kobe Bank, Ltd., dated July 1, 1975, CCH Fed. Sec. L. Rep. 80, 264 outlining the "nature and extent of State supervision" of a foreign bank operating in the U.S. under the Alien Bank Act (1973) of the State of Washington. The extent of such activities in the United States is indicated in footnote 1, page 5, supra.

^{3.} International Banking Act of 1976, H.R. 13876, 94th Cong. 2d Sess. (1976) (passed House of Representatives on July 29, 1976). The literature is voluminous. See, e.g., Zwick, Joint Economic Committee, Pape: No. 9, Foreign Banking in the United States, 89th Cong., 2d Sess. (1966); Klopstock, Foreign Banks in the United States: Scope and Growth of Operations, Federal Reserve Bank of New York Monthly Review (June 1973) 140; International Economic Report of the President (Transmitted to Congress Feb. 1974) 68; Financial Institutions and the Nation's Economy (FINE) Study - Discussion Principles (Title VI. Foreign Banks in the United States), WFR 11/10/75, T-70; House of Representatives Report No. 94-1193, 94th Cong., 2d Sess. (May 26, 1976) on International Banking Act of 1976.

In the case of an <u>unlicensed</u> foreign bank, in order to accomplish the policy of the Bankruptcy Act to secure possession of a bankrupt's assets to effect an equitable distribution among all creditors and to ensure an equitable distribution as between domestic creditors and foreign creditors, there may be situations where the filing of a petition in the United States against the foreign bank may be necessary for the purpose of collecting assets or setting aside preferences or fraudulent transfers. A foreign bank may wish to institute a voluntary proceeding in order to defend itself against a multiplicity of law suits. On the other hand, as Professor Nadelmann has pointed out, there may be cases where no useful purpose would be served by involving the bank in U.S. bankruptcy proceedings.

The provisions of Section 4-103 of the proposed Bank-ruptcy Act of 1975 (Administration of Debtors' Estates Involving More Than One Country) should provide sufficient flexibility to accomplish the purposes to be served by subjecting to U.S. bank-ruptcy jurisdiction a foreign bank of a type which should not be treated as a domestic bank.

In subjecting certain (unlicensed) foreign banks to both voluntary and involuntary bankruptcy in the United States, it should be recognized that a foreign bank, unlike an ordinary business enterprise, is entitled to special treatment in respect of involuntary proceedings. A bank, whether U.S. or foreign, is a unique type of business enterprise. Its very existence depends largely upon its deposit-taking function. In view of the volatility of bank deposits, this function renders banks peculiarly vulnerable to anything which casts the slightest suspicion upon the soundness of its financial condition1, thereby precipitating deposit outflow. The mere institution of a bankruptcy proceeding in the United States against a foreign bank would undoubtedly have a devastating effect upon the institution as a whole. Also, the social cost to the community of a bank failure can be extremely high2. An indication that a bank may be in serious trouble can impair the confidence of its depositors, create irreversible liquidity problems for the bank and possibly even cause a loss of public confidence in the banking

^{1.} See, for example, N.Y. Banking Law §671 (False statements or rumors as to banking institutions.); Investment Company Institute v. Camp, 401 U.S. 617, 631 (1971) ("***public confidence is essential to the solvency of a bank***").

^{2. 1974} Annual Report of Federal Reserve Bank of New York, page 16: "The closure of a German bank (Bankhaus I.D. Herstatt) toward the end of June [1974] had especially serious repercussions. Foreign exchange transactions were drastically curtailed immediately following the closure, with trading limited to names regarded in the market as having the highest quality. Subsequently, activity recovered, but smalland medium-size banks continued to experience trading difficulties both in the exchanges and in the Eurodollar market as credit lines were tightened for all but the best names." Deputy Secretary of the Treasury Stepen S. Gardner, in his testimony on January 28, 1976 on the proposed Foreign Bank Act of 1975 (S. 958, H.R. 5617), stated: "Banking is universally recognized as having a unique role in monetary and credit policies of nations ***. Washington Financial Reports, 2/2/76, T-8.

29 system itself. 1 For these reasons, no bank should be the subject of involuntary bankruptcy proceedings, whether liquidation or reorganization, except as a last resort.2 In this connection, attention is called to the fact that the proposed Bankruptcy Act of 1975 in Section 4-205 reduces the minimum number of petitioning creditors from 3 to 1 and generally substitutes the equity test of insolvency for the balance sheet test in determining whether relief is available on an involuntary basis. Under the Commission's Bill, one of the tests consists of whether the debtor will be "generally unable to pay his current liabilities as they become due". An inordinate amount of a bank's liabilities consist of "current liabilities" - primarily, demand deposit accounts. Such a test would make a bank unusually vulnerable to an involuntary petition and reinforces the fact that there should be some qualification on the presence of assets as a basis for the institution of bankruptcy proceedings against. a bank. It is likely that the type of foreign bank which has substantial assets in the United States - for example, Herstatt - will be subject to much the same money market considerations as the larger U.S. institutions. As a result of the shift in emphasis from "asset management" to "liability management", the larger banks have become increasingly dependent upon impersonal money market funds to finance their lending activities. Adverse news will trigger outflows of these funds. 3 In short, 1. Cf. the U.S. National Bank of San Diego situation in 1973 and the Franklin National Bank of New York situation in 1974. See Statement by Robert C. Holland, Member, Board of Governors of the Federal Reserve System, before the Subcommittee on Financial Institutions Supervision, Regulation and Insurance of the Committee on Banking, Currency and Housing, U.S. House of Representatives, July 16, 1975, reprinted in 61 Fed. Res. Bull. 419 (1975): "***We believed that the closing of a \$5 billion bank such as Franklin could have precipitated other bank failures with resulting large losses for many individuals and businessmen and for the Federal Deposit Insurance Corporation. This situation arose during a difficult period for financial institutions and financial markets; such a failure at that time could, in our judgment, have had serious adverse consequences for the stability of our Nation's banking system and for domestic and international financial markets in general." 2. Note that, by reason of special considerations applicable to banks (the question of precipitating a "run" on a bank and the effect upon "public confidence in the banking system"), the U.S. Securities and Exchange Commission "does not bring actions against banks without careful deliberation". Speech of John R. Evans, SEC Commissioner, reported in American Banker, 8/26/75, p.4. Similarly, a suggestion is mentioned in Sovern, Section 4 of the Bankruptcy Act: The Excluded Corporations, 42 Minn. L. Rev. 171, 219 (1957), that "if insurance corporations are brought under the Bankruptcy Act, the right to invoke the statute should be confined to state officials". 3. For discussion of the above principles, see 61 Fed. Res. Bull. 416-418, 424 (1975).

the dependence of banks upon liabilities withdrawable on demand or on short notice makes it imperative to endeavor to avoid situations which undermine banks' ability to attract funds. This consideration will in all probability apply to the international banks of the type most likely to have assets in this country - typically in the form of correspondent bank balances.

It might be said that attachment of such funds can have the same disastrous effect as the filing of a bankruptcy petition against the institution. There is much truth in such a contention. But the notoriety of a bankruptcy proceeding and its connotation are likely to have a much more severe impact than an attachment.

As to "reciprocity" considerations, making involuntary proceedings against foreign banks difficult to institute in this country should be helpful in deterring other countries from lightly permitting the commencement of insolvency proceedings against U.S. banks having assets there. Further, considerations of international comity suggest that foreign banks could, with some justification, object to a U.S. law which would make it easy to institute bank-ruptcy proceedings in the United States against a foreign bank merely on the basis of U.S. assets, in contradistinction to the situation of domestic banks which are not amenable to bankruptcy proceedings - so that, for example, creditors of a nationalized branch could use the leverage of the threat of a bankruptcy proceeding as a weapon to force a settlement. The principle of "national treatment", which is adhered to by the United States, also suggests restraint in treating foreign banks differently from domestic banks.

Creditors of a foreign bank should not be permitted to institute bankruptcy proceedings against the bank in the United States merely by reason of the existence of assets in this country. Such a proceeding should not be permissible unless a proceeding for liquidation or composition or other readjustment of debt, whether judicial or administrative, has been instituted in the country of the bank's domicile or in some other country affecting a substantial portion of the bank's assets. Where such a proceeding has already been instituted, there should then be no reason why creditors should not be entitled in an appropriate case to institute a bankruptcy proceeding in the United States. However, where a foreign proceeding is not commenced, the action of creditors in the United States should be confined to the usual non-bankruptcy procedures for the collection of claims.

Finally, it could be argued that the U.S. proceeding should not extend to property located outside the United States and that, given the nature of banking institutions in general, U.S. policy should defer to the policy of the country of the

^{1.} As of June 1975 foreign branches of U.S. banks had assets of \$162 billion. Washington Financial Reports, 11/10/75, T-11.

^{2.} Utley, Foreign Banks' Affiliation with United States Broker-Dealers:
The Statutory Language and Assumptions of the Bank Holding Company
Act, 7 Law & Policy in Int'l Business 1, 47 n.230 (1975).

^{3.} It should be recognized that the institution of a U.S. bankruptcy proceeding might well have adverse consequences in the foreign proceeding. But the jurisdiction of the Bankruptcy Court under §4-103 would not be compulsory and the options given to the foreign representative under §4-103(b) should enable him to deal with such eventuality.

bank's domicile, except in relation to property located in the United States. 1

In making the above recommendations relating to limitations on the filing of involuntary petitions and on jurisdiction over foreign assets, the Committee does not intend to indicate in any way that such limitations are also appropriate for non-bank debtors such as multinational business corporations. Rather, the Committee's recommendations are based entirely upon the unique nature of banking institutions in general as discussed above and upon the special nature of the particular type of banking institution covered by this Report as discussed under paragraph 1 on page 4 above. 2 In considering these particular recommendations, it should be kept in mind that the principal thrust of this Report is to recommend the exemption of this type of foreign bank from a proposed total exclusion from the Act of "banking corporations" in general. In other words, the Report recommends an exception from the general policy of the Act to exclude banks. This factor should be weighed in evaulating proposed limitations. It should be noted also that the proposed limitation on involuntary petitions would not have been applicable to Herstatt, Israel-British Bank or Finabank because of proceedings initiated in each case in the domiciliary country.

RECOMMENDATIONS

1. The general exclusion for "banking corporations", in Sections 4-201 and 4-204 of the Bankruptcy Act of 1975, should not extend to "any banking corporation organized under the laws of a country other than the United States unless such banking corporation (a) has a place of business in the United States which is licensed by, and is under the supervision of, a Federal or State authority having supervision over banks and (b) a major portion of its business in the United States consists of banking activities". Such a change in these sections would ensure that a foreign bank would not be treated as an exempt "banking corporation" unless its status in the United States is comparable to that of a domestic bank.

2. Cf. also the modern focus upon fairness in the exercise of judicial jurisdiction over defendants foreign to the forum, discussed in concurring opinion of Judge Gibbons in Jonnet et al. v. Dollar Savings Bank, F.2d (3rd Cir. 1976).

^{1.} Cf.: Bankruptcy Convention of European Economic Community, adopting the principle of the "unity" and "universality" of bankruptcy with bankruptcy jurisdiction in a single court (Arts. 2 and 17), confers jurisdiction on courts of the State where the "Center of Administration" of the debtor is situated. CCH Common Market Reports ¶6114, 6129. In view of the shortcomings of this Convention in handling the failure of a multi-national bank, it is argued in Simmons, Legal Concerns Seen in Bank Failures, Defaults on Foreign Exchange Deals, New York L.J., Vol. 175, No. 38, p. 29 (2/26/76) that the "drafting of a model treaty to deal with multi-national bank failures is necessary".

FORD MARRIN ESPOSITO WITMEYER & BERGMAN

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